Quarterly Manager Letter

Q1 2024

Current News and Updates

COMMENTARY

It seems we have reached a point where the primary cause of fear in markets – inflation – has receded but clearly not disappeared. Market participants have instead focused on increasing global growth, and the potential for declining interest rates over time. When combined with the optimism surrounding the potential of Artificial Intelligence (AI), you get a very strong first quarter with the S&P 500 returning 10.2% and the TSX up 5.8%. While there were many moving parts in the first quarter, we expect it to be an interesting second quarter as well with Canada poised to cut interest rates at their next meeting, growing evidence that the worst of the European downturn is behind us, and hope that stimulus efforts might limit any downside in the emerging market economies.

In hindsight, there are a series of factors which enabled the U.S. market to outperform over the last several years. First, consumer-led demand was much more stable in the U.S. as individuals smoothed their consumption by dipping more regularly into excess savings built up over the pandemic. Second, terms of trade are drastically different in the U.S., than say in Europe, where the latter is a large energy importer, and therefore suffers from any protracted rise in energy prices. Third, fiscal policy was loosened dramatically in the U.S., whereas it was tightened in many other economies.

We believe that the outlook for equities remains modestly positive, suggesting a cautious, but risk-on approach. We remain cautious due to the many tail risks, not least of which involves geopolitics, and the fact that although downside risks to the market appear lower in probability, they are relatively large in magnitude. It is also reasonable to be cautious of the impact of the stronger USD, and long-term interest rates, on economies worldwide. For the market to continue to do well, we believe that Q1 earnings results will be important. Although it is still early, greater than 90% of companies who have reported so far have beaten EPS estimates, while 76% have beaten sales estimates – solid results, indeed.

Aventine Canadian Equity (“ACE”) Fund

The Aventine Canadian Equity Fund had a strong quarter to start the year, returning 10.2% during the period. While the fund benefitted from a broadening rally in undervalued small-caps, we note that this progress was made despite cautious full-year outlooks from the group, supporting our belief that their recovery runway through 2024 is set up to continue to beat expectations.

During the quarter, we had several stocks outperform, including Sangoma (STC-CN; +55%), Trisura (TSU-CN; +23%), and Heroux Devtek (HRX-CN; +18%). When we rationalize the reason for outperformance across each of these names, it comes down to the theme of strong fundamentals and operational execution by undervalued companies. We believe that each is poised to see continued improvement through operational outperformance and re-ratings in multiples. The biggest laggard for the fund was ATS Automation (~-19%), a position we opportunistically resized (downwards) near peak levels, given our thoughts that the stock was priced for near-perfection. At current levels, however, we believe the stock is attractive and have been actively adding back exposure to capture the tailwinds from the current resiliency in the broader economy.

As we look to the rest of the year, we believe our companies have been adequately de-risked based on recent guidance and Q4-23 results, which sets them up for success. We are also excited about the prospects of two new additions to the fund, MDA (MDA-CN) and Converge Technology Solutions (CTS-CN). Here, we recycled capital from the monetization of our Jamieson Wellness (JWEL-CN) position to add favorable exposure to the tech sector, including providing satellite infrastructure to support global communication and space exploration.

Aventine U.S. Equity Fund

The Aventine U.S. Equity Fund performed well in the first quarter, returning 4.2% in USD. The results were helped by broadening market breadth as Financials and Industrials began to perform well after several months of market-lagging returns, and the stable interest rate regime meant stability in yield sensitive equities.

During the quarter, several of our large positions did well. Amazon (AMZN-US; +19%), Volkswagen (VWAGY-US; +17%), and Cemex (CX-US; +16%) all performed in the quarter as they benefitted from continued strength of the consumer, and a positive view of infrastructure spending in the U.S. and Mexico. By far our largest detractor was Zoetis (ZTS-US; -14%), as the stock front-ran a negative article published in the Wall Street Journal regarding the potential side effects of their companion animal pain medication Librela and Solensia. We view the article as immaterial with reports of side effects representing well less than 1% of the more than 18 million shots administered to date in the U.S. and abroad. Many veterinarians and pet owners have also reported success with the drugs, and animal-health researchers are unaware of a link between the drugs and the reported side effects.

We remain active in the fund and one recent addition to the portfolio was BHP Group Ltd (BHP-US). The Company mines and produces copper, iron ore, metallurgical coal, nickel, and potash, used in anything from global economic growth infrastructure to the energy transition. The future worldwide deficit in copper is very well known, and over the next few years, few are poised to grow copper production as much as BHP. In fact, BHP should become the world's largest producer as their Escondida mine in Chile continues to increase production. The company is inexpensive at approximately 5.5x EV/EBITDA and has a dividend yield over 5%.

Recently, we also added Entegris (ENTG-US) to the portfolio to expand our exposure to the semiconductor production cycle. Entegris provides chemicals, delivery products, and wafer transport products that are essential in the production of semiconductors for end market use. The Company is a clear beneficiary of both the buildout of semiconductor capacity as well as the outsized production volume to follow. As these trends progress, we expect the company to meaningfully de-lever its balance sheet, removing the largest overhang on the stock.

Outlook

As we look out to the rest of the year, we are focused on several key trends.

Recession Risk:
The risks of a global recession have receded considerably after appearing elevated last year. Despite the widespread calls for slowing growth, economic data has generally surprised to the upside. U.S. GDP continues to annualize above 3% and China's growth remains above 5%. As a result, surveys of business and consumer confidence remain strong, and unemployment remains near cycle-lows.

Inflation:
While strong economic growth is good for sentiment, it comes with a concerning inflation outlook. The U.S. economy added 353,000 jobs in January, the largest increase in over a year. Coincidentally, consumer prices rose 0.4%, another yearly record. When combined with continued positive wage growth, we may continue to see upward pressure on housing and services prices. In addition, several trends which have recently supported disinflation are now vanishing. Oil and durable good prices seem to have stabilized recently meaning any further progress here is unlikely.

Interest Rates:
The long end of the U.S. interest rate curve has the potential to impact global markets and has done just that since the end of the quarter. The U.S. 10yr is up nearly 45 bps in just a few weeks, and with this move up, asset market impacts have accelerated. For example, the S&P 500 is down nearly 4% since the end of the quarter alone. Ultimately, it will be economic data which drives the rates market, and although we anticipate a modest decline this year, we must prepare for U.S. 10-year rates to be range bound between 4.5% and 5.0%.

Geopolitics:
With the U.S., the U.K., India, and other major countries holding elections this year, the outlook for any political impact on financial markets remains opaque. With clearly differing platforms on corporate taxes, loan forgiveness, income taxes, tariffs, defense spending, and immigration, we could see obvious shifts in the fiscal outlook. Currently, geopolitical uncertainty continues in Ukraine, Israel, the Red Sea, and East Asia. The potential for fresh disruptions in these regions could clearly impact global shipping and natural resource supplies.

There is no doubt that stocks have enjoyed a strong rally recently, however, inflation remains elevated in the U.S., leading to a resurgence in interest rate volatility. Rates are not declining as quickly as many had hoped at the start of the year. This leads us to retain a cautiously optimistic view on equities over the medium term. We expect continued strength in the global economy; however, we note that valuations seem stretched given the current absolute level of interest rates. While this leads us towards a more neutral equity stance, we continue to position clients to take advantage of yields in income generating products.
Thank you for your continued support of Aventine as your Investment Manager and Investment Counsellor. Please do not hesitate to reach out to learn more about our investment strategies.

We are always excited to discuss our clients' accounts with them and how we may be of greater value.

Best as always,
James, Jim, David, Shannon, and Nicho

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Aventine Performance Update

March 31, 2024

Aventine's Partners and their families are among the largest investors across each of our strategies.

Aventine Balanced Composite

Inception: June 1, 2009

Aventine Balanced is our core portfolio for separately managed accounts following a "balanced" mandate. It is an actively managed, endowment-style portfolio that offers investors diversified exposure to a broad variety of markets and asset classes. This diverse portfolio produces below average volatility and high income generation as we include asset classes such as private debt, mortgages, traditional and non-traditional fixed income, all-cap equities, alternatives and portfolio protection through prudent risk management strategies.

	Q1	2024
Aventine Balanced Composite	**4.9%**	**4.9%**

Annualized	3 Year	5 Year	Inception
	1.0%	**5.2%**	**6.6%**

Additional performance information and disclosures on composite construction is available upon request.

We encourage new clients to join Aventine by investing in our customized portfolio solutions which are tailored to your specific goals.

To learn more about how our independent approach to managing wealth differs from traditional models please feel free to contact us anytime.

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This email communication is intended to provide you with information about the Aventine Balanced Composite (the "Composite"), the Aventine Canadian Equity Fund and the Aventine Dividend Fund (the "Funds") managed by Aventine Management Group Inc. The Funds are distributed by prospectus exemption in various jurisdictions across Canada, please contact Aventine Management Group Inc. to discuss if you may be eligible to invest. Important information about each Fund is contained in its Offering Memorandum which should be read carefully before investing and may be obtained from Aventine Management Group Inc. upon request. The Offering Memorandum does not constitute an offer or solicitation to anyone in any jurisdiction in which such an offer or solicitation is not authorized, or to any person to whom it is unlawful to make such an offer or solicitation. All investors should fully understand their risk tolerance and the suitability of the Composite and the Funds prior to making any investment. Rates of return presented for all periods greater than one year are the historical annualized compound total returns for the period indicated. For periods less than one year the rates of returns are a simple period total return. Rates of return do not take into account income taxes payable that would have reduced net returns. The performance presented for the Funds is the performance of the target series of F Class units. The value of the Composite and the Funds is not guaranteed and will change frequently. Past performance may not be repeated. All credited third-party information contained herein has been obtained from sources believed to be reliable at the time of writing, but Aventine Management Group Inc makes no representations as to its accuracy.

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